



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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CC:PA:APJP:B02
JBernstein

MEMORANDUM FOR DIRECTOR OF APPEALS SBSE-TEGE OPERATING UNIT
AP:SBSE-TEGE
ATTN: MARY M. CARROLL

FROM: Assistant Chief Counsel, Administrative Provisions and Judicial
Practice (CC:PA:APJP)

SUBJECT: Abatement of the Frivolous Income Tax Return Penalty

This responds to your request for guidance concerning the assessment and abatement
of a frivolous income tax return penalty. I.R.C. § 6702. [REDACTED]

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ISSUES

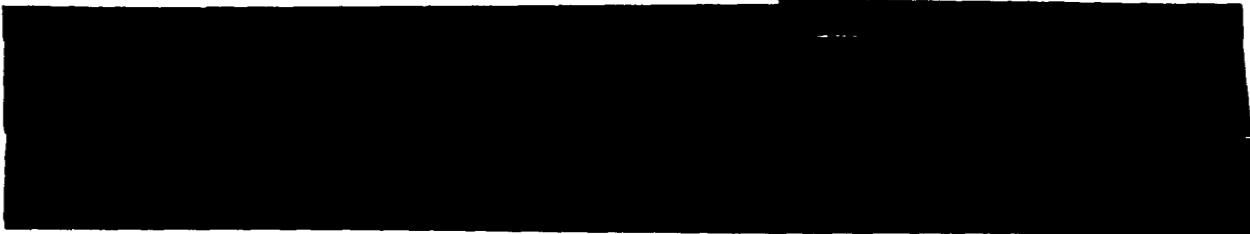
1. Whether Appeals has the authority to abate or settle frivolous income tax return penalties assessed under section 6702 of the Code.
2. Whether Service functions have the authority to disregard or change Appeals' settlement adjustments or decisions to abate frivolous income tax return penalties assessed under section 6702.

CONCLUSIONS

1. Appeals has the authority to abate penalties assessed under section 6702, although reasonable cause is not a legal ground for abating section 6702 penalties. Appeals should not abate a section 6702 penalty because it determines that reasonable cause exists for filing a frivolous return.

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FACTS

Section 6702 provides for an immediate assessment of a \$500 civil penalty against individuals who file frivolous income tax returns. Before the Service assesses such a penalty, the Ogden Service Center, which handles all frivolous returns and any resulting penalties, sends a letter to the individual indicating that a \$500 penalty will be assessed for each frivolous return filed, absent the filing of a nonfrivolous return within 30 days. If the Ogden Service Center does not receive a nonfrivolous return within the 30 days, the Service assesses the penalty.

After assessment, a taxpayer may choose to pay the penalty and then seek relief by filing a claim for refund. Some taxpayers choose to meet with Appeals in an attempt to resolve an assessed section 6702 penalty. If a taxpayer does not pay the penalty or seek an administrative solution, such as meeting with Appeals, the Service may commence collection activity by filing a notice of federal tax lien or proposing a levy. If the Service takes either of those collection actions, the taxpayer generally can challenge a section 6702 penalty before Appeals in a postassessment Collection Due Process (CDP) hearing. See IRC §§ 6320, 6330.

It is our understanding that Appeals wants to provide postassessment administrative appeal opportunities regarding section 6702 penalties. It is also our understanding that, in some instances, Appeals officers have abated section 6702 penalties on the basis that the frivolous return filing was due to reasonable cause. Appeals also abates or settles section 6702 penalties in other circumstances, such as the assessment of multiple penalties when several schedules are attached to a single income tax return.

DISCUSSIONA. Appeals' Authority Over the Section 6702 Penalty

Commissioner Delegation Order No. 66, Authority of Appeals in Protested and Tax Court Cases, (Rev. 15)(supp. 10/02/00)("CDO 66"), delegates authority to various Appeals officials to "represent the Commissioner" in determining liability for specific

types of cases "not docketed in the United States Tax Court where the taxpayer does not agree with the determination made by" various Service officials. CDO 66, ¶ 2. Appeals has been delegated authority to represent the Commissioner in cases that include "additions to tax, additional amounts and assessable penalties under Chapter 68" of the Code and "penalty appeals." CDO 66, ¶ (2)a-b. Delegation Order 66 also provides delegated officials, such as various Appeals officials, authority to enter into a written agreement concerning the tax liability of an individual with respect to matters within their jurisdiction. CDO 66, ¶ (5). Thus, because the section 6702 penalty is an assessable penalty under Chapter 68, Appeals has the authority to represent the Commissioner with respect to the penalty. Additionally, under paragraph 12 of CDO 66, the Regional Director of Appeals and/or Director, Appeals Operating Unit have the authority to redelegate the settlement of appeals and assessed penalties (including the section 6702 penalty) to Appeals officers and settlement officers.

Section 601.106(a)(1)(iv) of the Statement of Procedural Rules, which addresses postassessment penalty appeal procedures, appears to conflict with the foregoing delegation order.¹ Specifically, section 601.106(a)(1)(iv) provides that certain Chapter 68 penalties may be appealed after assessment. Statement of Procedural Rule section 601.106(a)(1)(iv)(a), however, indicates that postassessment appeal does not apply to penalties that are not subject to a reasonable cause or reasonable basis determination. Section 6702 is not subject to a reasonable cause or reasonable basis determination. Therefore, the Statement of Procedural Rules does not provide for appeal of a section 6702 penalty. The Internal Revenue Manual (IRM), however, is contrary to the Statement of Procedural Rules and expressly provides that penalties under section 6702 for returns filed after December 31, 1989, may be appealed under the postassessment penalty appeal program. See IRM 8.11.1.10.1(4).

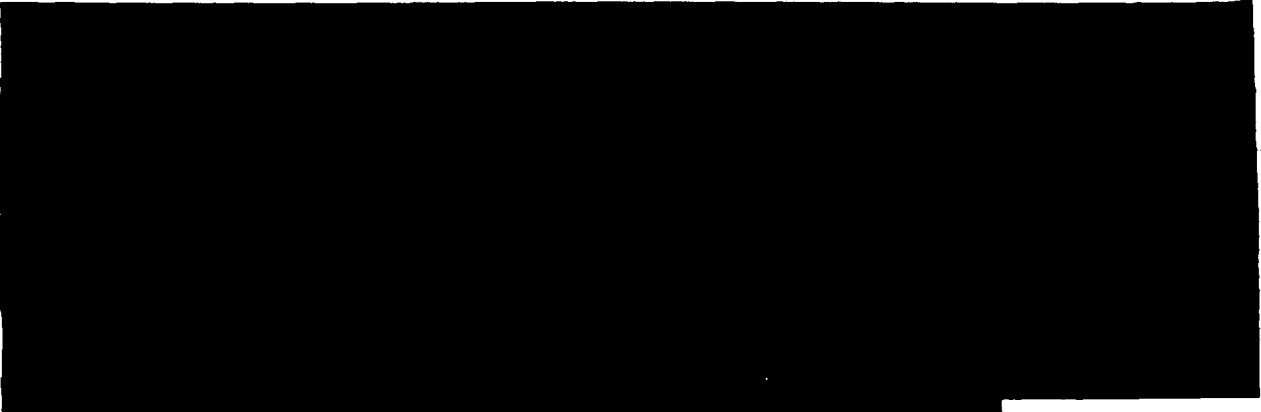
Sorting out the conflicting provisions above, we conclude that IRM 8.11.1.10.1(4) is legal and valid. Delegation Order 66, as previously discussed, provides authority for Appeals to represent the Commissioner with respect to appealed nondocketed section 6702 penalties in addition to other Chapter 68 penalties. CDO 66 expressly grants authority "to Appeals to settle appeals of assessed penalties" of nondocketed cases. While Statement of Procedural Rules section 601.106(a)(1)(iv) does not recognize a postassessment appeal procedure for penalties that have no reasonable cause or reasonable basis component, such as the frivolous return penalty in section 6702, it is not a legal obstacle to Appeals' authority to offer postassessment appeals with respect to section 6702 penalties. Courts have found that the Statement of Procedural Rules provides mere guidance and does not have the full force and effect of law. See *Luhning v. Glotzbach*, 304 F.2d 560 (4th Cir. 1962). [REDACTED]

¹ On September 20, 1993, the Service issued proposed regulations to clarify, update, and reorder some of the Part 601 regulations. The proposed regulations do not substantively change the regulations sections pertinent to our discussion.

Reconciling the Statement of Procedural Rules with the IRM will help ensure that appeal meetings regarding the assessment of section 6702 penalties are uniformly available, and at the same time, will publicize that reasonable cause does not provide legal justification for abating or settling a section 6702 penalty.

B. Authority to Challenge Appeals

As previously mentioned, the Code does not authorize the abatement of the section 6702 penalty on grounds of reasonable cause or reasonable basis. Because any abatement made on such a basis would be unauthorized by statute, we do not believe that a settlement providing for such an abatement would be binding on the government unless it were in the form of a closing agreement. It is possible, however, that given the facts of a particular case, there might be an alternative basis, within the terms of the statute, for a determination that the penalty should not be imposed.



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² The Appeals Division is a fully integrated and independent function in accordance with section 1001 of the IRS Restructuring and Reform Act of 1998 with its Chief reporting to the Office of the Commissioner of Internal Revenue, not the Commissioner directly. See T.O. 150-02, Organization and Functions of the Internal Revenue Service (March 9, 2001); see also I.R.M. 1.1.7.

If you have any questions regarding this matter, please contact Ashton P. Trice at (202)622-4940.

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